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HDFC Bank

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Structural strength to drive earnings…

HDFC Bank, a new-generation bank, is the second largest private sector bank in India. The Bank has a nationwide distribution network of 4,729 branches and 12,259 ATM's in 2,669 cities/towns as of Q2FY18. The bank has grown its balance sheet at a healthy pace of 21% CAGR over FY12-17 maintaining high profit CAGR of 23%.

Investment Rationale

- **Strong traction in loan growth across segments:** HDFC bank's advances grew at a robust CAGR of 23% over FY12-17 attributed by the strong growth in both retail and wholesale advances. The bank's loan book has healthy mix of retail and wholesale assets (53:47) as of FY17. Going forward, we expect the bank to continue to outpace the industry growth rate (8-9%) and factor 20% CAGR in advances over FY17-19E supported by the bank's robust retail franchise.

- **Superior retail liability franchise:** HDFC Bank enjoys superior liability franchise as the bank has successfully maintained CASA ratio above 43% over the last five years which benefits it with the lowest cost of funds compared to peers. Further, with a decrease in savings rate, we expect the cost of funds to decline further for the bank. With 4,729 branches and focus on retail banking, we expect the CASA Ratio to remain in the range of 45%-50%.

- **Net Interest Margin (NIM) intact:** HDFC Bank has consistently maintained its NIM at a superior level of ~4.5%+ over the last five years even as market yields in the overall economy were falling. Despite pricing pressure, NIMs are expected to sustain at the current levels over FY17-19E on account of following factors. (1) Higher CASA ratio, and (2) Higher share of fixed rate retail loans.

- **Unmatchable asset quality:** HDFC bank's asset quality continued to remain stable as Gross and Net non-performing asset (NPA) ratios stood at 1.3% (↑2 bps QoQ) and 0.4% (↓1 bp QoQ), respectively as of Q2FY18. Notably, both Gross and Net NPA ratios remained almost unchanged over the last five years. Going forward, we don't expect any negative surprise on asset quality front and expect asset quality to remain broadly stable with Gross/Net NPA ratios of 1.3%/0.4% by FY19E.

- **Robust profitability:** Superior asset quality and faster than systemic credit growth has enabled HDFC Bank to maintain the earnings momentum. As a result, HDFC Bank's net profit has grown at a robust pace of 23% CAGR over FY12-17. Going forward, we expect NII and net profit to grow at a healthy CAGR of 20% and 21%, respectively over FY17-19E supported by stable NIM of around 4.6%.

Valuation: We are structurally positive on HDFC Bank considering its best in-class asset quality (Gross/Net NPA of 1.3%/0.4% by FY19E), superior deposit franchise and credit underwriting ability. It will help the bank to maintain superior return ratios with RoE of 20% and RoA of 2% over FY17-19E. Overall, the bank is well placed to benefit from the expected pick-up in the economic growth cycle. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,000 (4.6x FY19E P/ABV).

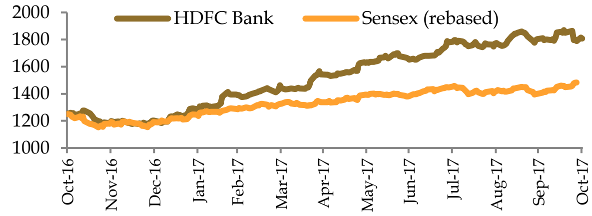
Market Data

Rating	**BUY**
CMP (Rs.)	1,807
Target (Rs.)	2,000
Potential Upside	11%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	1,877/1,159
Adj. all time High (Rs.)	1,877
Decline from 52WH (%)	3.7
Rise from 52WL (%)	55.9
Beta	0.9
Mkt. Cap (Rs.Cr)	467,300

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Interest Income (Rs.Cr)	60,221	69,306	81,381	95,152
Interest Expense (Rs.Cr)	32,630	36,167	41,465	47,162
Net Interest Income (Rs. Cr)	27,592	33,139	39,916	47,990
Pre Pro Profit (Rs. Cr)	21,364	25,732	31,626	38,224
EPS	48.6	56.8	68.6	82.5
P/E (x)	37.2	31.8	26.3	21.9
P/BV (x)	6.3	5.2	4.8	4.0
P/ABV (x)	6.4	5.3	4.9	4.1
ROE (%)	18.3	17.9	18.9	19.9
ROA (%)	1.9	1.9	2.0	2.1

One-year Price Chart



Shareholding Pattern	Sep-17	Jun-17	Chg.
Promoters (%)	25.7	25.9	(0.2)
Public (%)	74.3	74.1	0.2

FUNDSINDIA

HDFC Bank - Company Overview

HDFC Bank is the second largest private sector bank in India.

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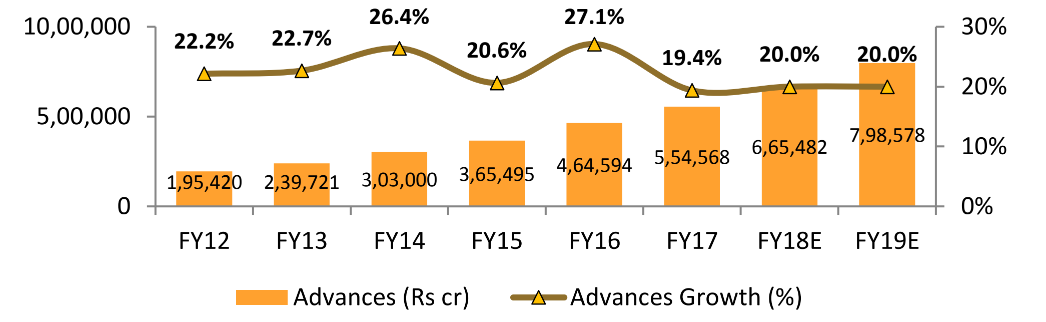
Strong traction in loan growth across segments

HDFC bank's advances grew at a robust CAGR of 23% over FY12-17 attributed by the strong growth in both retail and wholesale advances. The bank's loan book has healthy mix of retail and wholesale assets (53:47) as of FY17. Going forward, we expect the bank to continue to outpace the industry growth rate (8-9%) and factor 20% CAGR in advances over FY17-19E supported by the bank's robust retail franchise.

Advances to grow at a CAGR of 20% over FY17-19E

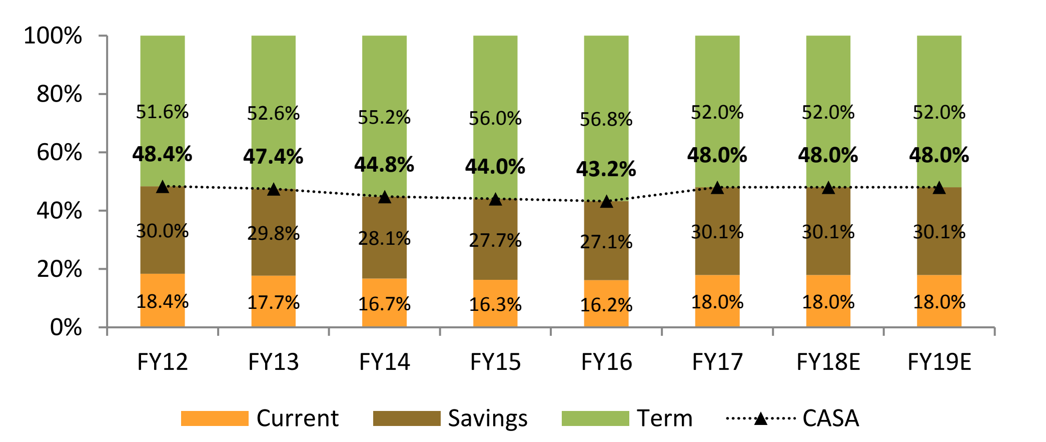


Source: Company, In-house research

Superior retail liability franchise

HDFC Bank enjoys superior liability franchise and scores one of the highest CASA ratio in the financial space. The bank has successfully maintained CASA ratio above 43% over the last five years which benefits it with the lowest cost of funds compared to peers. Further, with a decrease in savings rate, we expect the cost of funds to decline further for the bank. With 4,729 branches and focus on retail banking, we expect the CASA Ratio to remain in the high range of 45%-50%. We expect deposits to growth at a CAGR of 15% over FY17-19E driven by the strong traction in retail deposits.

CASA ratio is one of the best in the industry

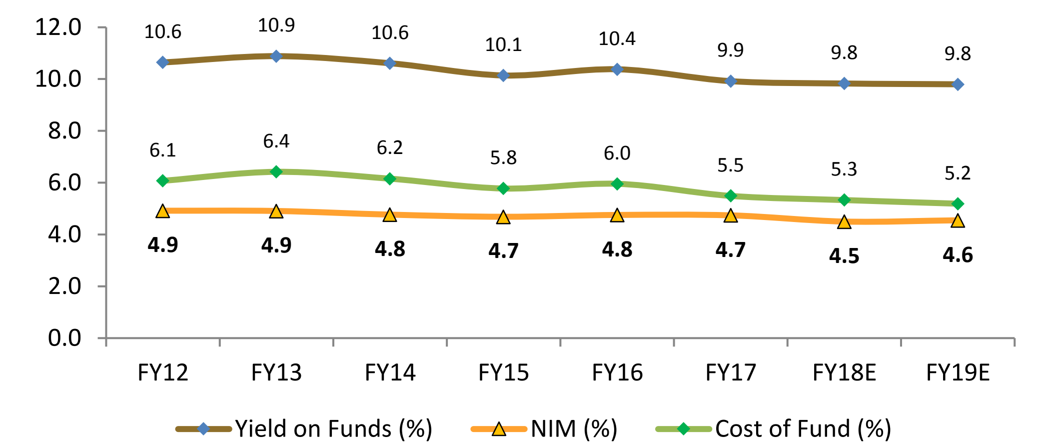


Source: Company, In-house research

Net Interest Margin (NIM) intact

HDFC Bank has consistently maintained its NIM at a superior level of ~4.5%+ over the last five years even as market yields in the overall economy were falling. The higher proportion of retail loans in the bank's portfolio has aided in maintaining the net interest margins. Despite pricing pressure, NIMs are expected to sustain at the current levels over FY17-19E on account of following factors. (1) Higher CASA ratio, and (2) Higher share of fixed rate retail loans (~2/3 of total retail book).

NIM to remain stable around 4.6% over FY17-19E

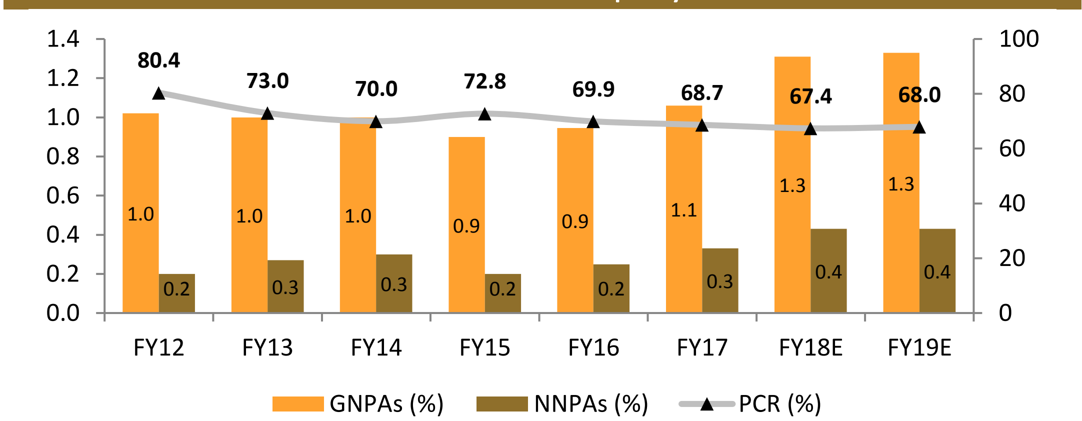


Source: Company, In-house research

Unmatchable asset quality

HDFC bank's asset quality trend continues to be relatively stronger than peers despite challenging macro environment largely due to stringent credit origination practices, relentless monitoring system and adequate provisioning. Notably, the bank's asset quality continued to remain stable as Gross and Net non-performing asset (NPA) ratios stood at 1.3% (↑2 bps QoQ) and 0.4% (↓1 bp QoQ), respectively as of Q2FY18. Notably, both Gross and Net NPA ratios remained almost unchanged over the last five years. Going forward, we don't expect any negative surprise on asset quality front and expect asset quality to remain broadly stable with Gross/Net NPA ratios of 1.3%/0.4% by FY19E.

Best in-class asset quality

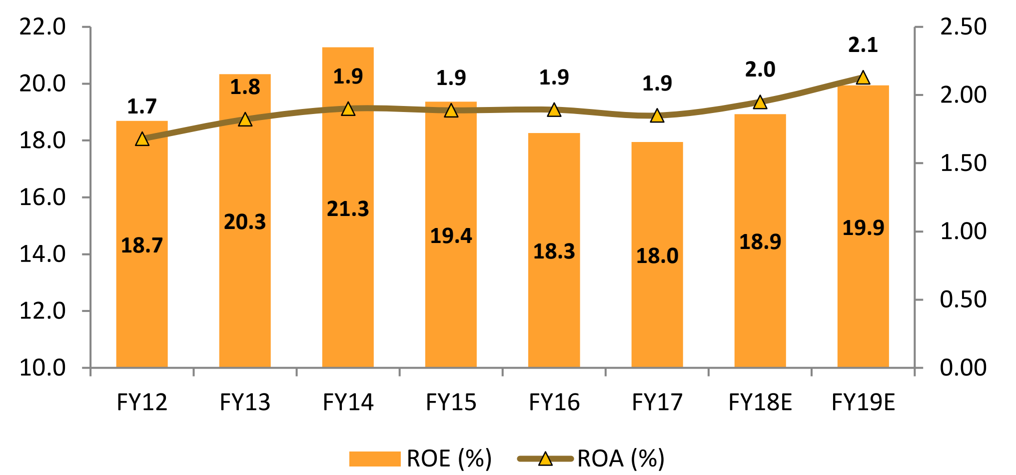


Source: Company, In-house research

Robust profitability

Superior asset quality and faster than systemic credit growth has enabled HDFC Bank to maintain the earnings momentum. As a result, HDFC Bank's net profit has grown at a robust pace of 23% CAGR over FY12-17. As a result, the bank has consistently maintained its RoE and RoA in the range of ~18-21% and 1.8-1.9%, respectively over the last five years. Going forward, we expect net interest income (NII) and net profit to grow at a healthy CAGR of 20% and 21%, respectively over FY17-19E supported by stable NIM of around 4.6%. Therefore, we forecast RoE and RoA to improve to 19.9% and 2.1%, respectively by FY19E.

Return ratios to remain robust over FY17-19E

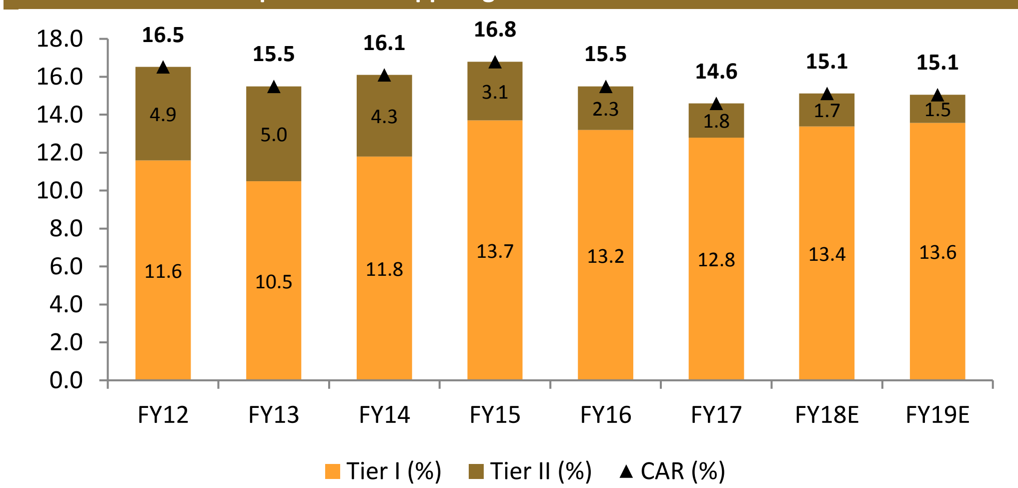


Source: Company, In-house research

Adequately capitalized

The Bank's capital adequacy ratio (CAR) as per Basel III norms continues to remain strong at 14.6% with Tier-I capital ratio of 12.8%. This will help the bank to grow its business at a strong pace without raising fresh equity in the near to medium term. The bank has relatively high Tier I capital adequacy ratio, which we believe is comforting in the current stressed environment.

Well capitalized to support growth momentum over FY17-19E



Source: Company, In-house research

Outlook and Valuation

We are structurally positive on HDFC Bank considering the bank's rich track record of impressive business & profitability growth, superior NIM, robust asset-liability management, fine balance between corporate & retail exposure, impressive risk appetite and healthy return profile since inception. Overall, the bank is well placed to benefit from the expected pick-up in the economic growth cycle. As a result, we expect the bank to see strong growth momentum in its loan book on the back of continuing retail loans origination along with market share gains in the corporate loans segment. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,000 (4.6x FY19E P/ABV).

Key Risks:

- **Lower growth than expected:** We expect loan growth of 20% over FY17-19E largely led by higher growth in retail assets. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.
- **Increase in slippages:** We have factored in credit cost of 0.7% and 0.8% for FY18E and FY19E, respectively. Increase in slippages beyond our estimates can result into increase in credit cost and hence it may affect the profitability of the bank.
- **Spike in Interest rates:** We expect the interest rate (repo rate) to remain broadly stable over FY17-19E. However, any further increase in interest rates may affect the margins of the bank and hence the operating matrix. Additionally, it may have negative impact on investments in capex, which may also impact asset quality of the bank adversely.

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	60,221	69,306	81,381	95,152
Interest Expense	32,630	36,167	41,465	47,162
Net Interest Income	**27,592**	**33,139**	**39,916**	**47,990**
Non Interest Income	10,752	12,296	14,069	16,161
Net Income	38,343	45,436	53,985	64,151
Operating Expenses	16,980	19,703	22,359	25,928
Total Income	70,973	81,602	95,450	111,313
Total Expenditure	49,610	55,870	63,825	73,090
Pre Provisioning Profit	**21,364**	**25,732**	**31,626**	**38,224**
Provisions	2,726	3,593	4,645	5,773
Profit Before Tax	18,638	22,139	26,981	32,451
Tax	6,342	7,589	9,249	11,124
Net Profit	**12,296**	**14,550**	**17,732**	**21,326**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Liabilities				
Capital	506	513	517	517
Reserves and Surplus	72,172	88,950	97,382	115,452
Deposits	546,424	643,640	740,186	851,213
Borrowings	53,018	74,029	98,817	126,566
Other Liabilities and Provisions	36,725	56,709	50,018	59,445
Total Liabilities	**708,846**	**863,840**	**986,918**	**1,153,194**
Assets				
Cash and Balances	38,919	48,952	59,215	62,990
Investments	163,886	214,463	222,056	255,364
Advances	464,594	554,568	665,482	798,578
Fixed Assets	3,343	3,627	3,934	3,934
Other Assets	38,104	42,230	36,232	32,327
Total Assets	**708,846**	**863,840**	**986,918**	**1,153,194**

Key Ratios (Standalone)

Y/E	FY16	FY17	FY18E	FY19E
Per share data (Rs.)				
EPS	48.6	56.8	68.6	82.5
DPS	9.5	9.5	10.0	10.5
BV	287.5	349.1	378.9	448.8
ABV	282.2	341.9	367.8	435.6
Valuation (%)				
P/E	37.2	31.8	26.3	21.9
P/BV	6.3	5.2	4.8	4.0
P/ABV	6.4	5.3	4.9	4.1
Div. Yield	0.5	0.5	0.6	0.6
Capital (%)				
CAR	15.5	14.6	15.1	15.1
Tier I	13.2	12.8	13.4	13.6
Tier II	2.3	1.8	1.7	1.5
Asset (%)				
GNPA	0.9	1.1	1.3	1.3
NNPA	0.3	0.3	0.4	0.4
PCR	69.9	68.7	67.4	68.0
Management (%)				
Credit/ Deposit	85.0	86.2	89.9	93.8
Cost/ Income	44.3	43.4	41.4	40.4
CASA	43.2	48.0	48.0	48.0
Earnings (%)				
NIM	4.8	4.7	4.5	4.6
ROE	18.3	17.9	18.9	19.9
ROA	1.9	1.9	2.0	2.1

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** HDFC Bank is a large-cap bank

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